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Department of the Treasury
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Legend

Employer A =
Plan X =

State C =

Dear :

This is in response to your letter of February 3, 2011, as supplemented by correspondence dated April 18, 2011, requesting letter rulings on two issues involving Employer A's deferred compensation plan (Plan X). You requested rulings on the following two questions:

1. Whether Plan X qualifies as a retirement system within the meaning of Internal Revenue Code (Code) § 3121(b)(7)(F); and
2. Whether service performed by a participant in Plan X is excluded from "employment" under Code § 3121(b)(7)(F) and the regulations thereunder.

Facts:

It is represented that Employer A is a political subdivision of State X. Employer A maintains Plan X for certain of its employees. Plan X is a defined benefit retirement plan that is intended to be qualified under Code § 401(a). Plan X is intended to be a retirement system under Code § 3121(b)(7)(F).

Plan X section 5.1 provides that an eligible employee will become a plan participant on the date the individual begins employment. Plan X section 2.1 defines employee in pertinent part as a "full-time employee." Employer A may, from time to time, employ part time and temporary employees who are not eligible to participate in Plan X. Plan X section 5.1 provides that employees who first become firefighters after the age of 36 are

not eligible to participate in Plan X without the approval of the Board of Trustees and the satisfaction of various listed conditions.

Plan X section 6.1(b) provides that the amount of normal retirement benefit under Plan X is a monthly payment equal to the product of a member's credited service multiplied by the member's highest average monthly pay multiplied by 1.67%. Plan X section 5.1(a) provides that credited service means service for which a member makes a contribution, calculated in years and completed months.

Plan X section 2.1(a) provides that "highest average monthly pay" means the average compensation of a member based on the sixty consecutive months of service with Employer A which yields the highest monthly average. Plan X section 2.1(a) defines "compensation" as all wages within the meaning of Code § 3401(a), and all other compensation for which Employer A is required to furnish a Form W-2, Wage and Tax Statement, but excluding (1) lump sum payments for unused sick and vacation pay upon termination of employment and (2) payments in addition to an employee's base pay that are due to overtime, other than standard overtime pay, and "step-up service" under which additional payments are made for a period of temporary service during which the employee is performing duties of a higher classification. Compensation also includes any amounts that were subject to a compensation reduction election under Code §§ 125, 132(f), 401(k), 403(b), and 457(b).

Law

Code § 3121(b)(7)(F) generally includes in employment for Federal Insurance Contributions Act (FICA) purposes the services of employees of states, political subdivisions, and instrumentalities of the foregoing, if they are not members of a retirement system within the meaning of Code § 3121(b)(7)(F).

Employment Tax Regulation (Regulation) section 31.3121(b)(7)-2(b) generally treats an employee as a member of a retirement system if he or she participates in a system that provides retirement benefits, or has an accrued benefit, or receives an allocation under the system that is comparable to the benefits he or she would have received under social security.

Regulation section 31.3121(b)(7)-2(e)(1) provides that for purposes of Code § 3121(b)(7)(F), a retirement system includes any pension, annuity, retirement or similar fund or system within the meaning of section 218 of the Social Security Act that is maintained by a State, political subdivision or instrumentality thereof to provide retirement benefits to its employees who are participants.

Regulation section 31.3121(b)(7)-2(d)(1)(i) provides the general rule for determining qualified participant status in a defined benefit retirement system. Qualified participant status is determined as services are performed. An employee is a qualified participant

in a defined benefit retirement system with respect to services performed on a given day if under the plan he or she has a total accrued benefit that meets the minimum benefit requirement.

Regulation section 31.3121(b)(7)-2(e)(2)(i) provides that the minimum benefit requirement is not satisfied unless the retirement system provides a retirement benefit to the employee that is comparable to the benefit provided under the Old-Age portion of the Old-Age, Survivor, and Disability Insurance program of Social Security. A defined benefit retirement system meets the minimum benefit requirement with respect to an employee if the employee has an accrued benefit under the system that entitles the employee to an annual benefit under the system commencing on or before his or her Social Security retirement age that is at least equal to the annual Primary Insurance Amount the employee would have under Social Security. See Regulation section 31.3121(b)(7)-2(e)(2)(ii).

Revenue Procedure 91-40, 1991-2 C.B. 694, outlines a set of safe harbor formulas for defined benefit retirement systems. Benefits calculated pursuant to the rules of Rev. Proc. 91-40 are deemed to meet the minimum retirement benefit requirement of the regulations.

Section 3.01(2) of Rev. Proc. 91-40 provides that a defined benefit retirement system that calculates benefits by reference to a participant's average compensation over a period of 60 months meets the minimum benefit requirement with respect to an employee if it makes available to the employee a single life annuity payable beginning no later than age 65 that is at least equal to 1.60 percent of average compensation for each year of credited service.

Section 3.03(1)(a) of Rev. Proc. 91-40 requires that a defined benefit retirement system must calculate benefits based on definition of compensation that satisfies the requirements of Regulation section 31.3121(b)(7)-2(e)(2)(iii)(B). This section provides that a definition of compensation used in determining whether a retirement system meets the minimum benefit requirement must be no less inclusive than base pay as designated by the employer or retirement system, provided such designation is reasonable under all the facts and circumstances.

Revenue Procedure section 3.03(2)(a) provides that in order to meet the safe harbor formula, a defined benefit retirement system must generally include in credited service the employee's entire period of service with the employer since commencing participation in the retirement system, plus any past service credited under the retirement system, except to the extent that service is treated as employment under Code § 3121(b).

Analysis

Issue 1: Whether Plan X qualifies as a retirement system within the meaning of Code § 3121(b)(7)(F).

Section 3.03(1)(a) of Revenue Procedure 91-40 provides that to meet the requirements of any of the defined benefit safe harbor formulas, a retirement system must calculate benefits based on a definition of compensation that complies with section 31.3121(b)(7)-2(e)(2)(iii)(B) of the regulations, which provides that compensation must be no less inclusive than the definition of the employee's base pay as designated by the employer or the retirement system, provided that such designation is reasonable under all the facts and circumstances. Plan X satisfies this requirement by providing a definition of "compensation" that is no less inclusive than base pay. Plan X section 2.1(a) defines "compensation" as "all wages within the meaning of Code § 3401(a), and all other compensation" for which Employer A is required to furnish a Form W-2, Wage and Tax Statement.

Plan X section 2.1(a) provides that benefits will be calculated by reference to a member's highest average monthly pay, which is defined as the member's average monthly compensation based on the sixty consecutive months of service with Employer A which yields the highest monthly average. Section 3.01(2) of Revenue Procedure 91-40 provides that a defined benefit retirement system that calculates benefits by reference to a participant's average compensation over a period of 60 months meets the minimum benefit requirement with respect to an employee if it makes available to the employee a single life annuity beginning no later than age 65 that is at least 1.60 percent of average compensation for each year of service. Plan X section 6.1(b) satisfies the above criteria by making available in the form of a single life annuity at age 65 a monthly payment equal to the product of a member's credited service multiplied by the member's highest average monthly pay multiplied by 1.67%.

Plan X satisfies the minimum benefit requirements of Regulation section 31.3121(b)(7)-2 using the safe harbor formulas set forth in Revenue Procedure 91-40. Thus, Plan X qualifies as a retirement system within the meaning of Code § 3121(b)(7)(F).

2. Whether service performed by a Plan X participant is excluded from employment under Code § 3121(b)(7)(F) and the regulations thereunder.

Plan X provides that eligible employees participate in Plan X as of the day their employment commences. An eligible employee participates in the Plan as long as employed by employer A.

We conclude that the services participants in Plan X perform for Employer A are excepted from employment for FICA purposes under Code § 3121(b)(7)(F) as long as

the participants are qualified participants in Plan X within the meaning of Regulation section 31.3121(b)(7)-2(d).

However, wages paid to employees excluded from participation in Plan X are subject to FICA taxation pursuant to Code § 3121(b)(7)(F), as the services of such employees are includible in employment for purposes of FICA taxes.

The above analysis is based on the assumption that Employer A is not covered by an agreement entered into pursuant to section 218 of the Social Security Act within the meaning of Code § 3121(b)(7)(E).

This ruling is directed only to the taxpayer requesting it. Code § 6110(k)(3) provides that it may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Lynne Camillo
Branch Chief, Employment Tax Branch 2 (Exempt
Organizations/Employment Tax/Government
Entities)
(Tax Exempt & Government Entities)